



*United States Attorney  
Southern District of New York*

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**GERMAN BANK HVB ADMITS CRIMINAL WRONGDOING AND AGREES  
TO PAY \$29 MILLION AS PART OF DEFERRED PROSECUTION  
AGREEMENT IN RELATION TO LARGEST-EVER TAX SHELTER FRAUD**

MICHAEL J. GARCIA, United States Attorney for the Southern District of New York, announced today that German Bank BAYERISCHE HYPO- UND VEREINSBANK AG ("HVB") has admitted to criminal wrongdoing and agreed to pay \$29,635,125 in fines, restitution and penalties as part of an agreement to defer prosecution of the bank in relation to its participation in the implementation of fraudulent tax shelters devised by the accounting firm KPMG and others. The Deferred Prosecution Agreement was accepted by United States District Judge ALVIN K. HELLERSTEIN.

In what is believed to be the largest criminal tax case ever filed, KPMG previously admitted in a Deferred Prosecution Agreement that, together with others, it engaged in a fraud that generated at least \$11 billion dollars in phony tax losses which, according to the charge filed against KPMG, cost the United States at least \$2.5 billion dollars in evaded taxes. Indictments returned in August and October of 2005 charge nineteen individuals – including seventeen former KPMG partners or managers – with various tax offenses based on their participation in the fraud. That case, United States v. Stein, et al., S05 CR 888 (LAK), is scheduled to go to trial in September 2006.

The felony Information filed today charges HVB with one count of conspiracy to defraud the Internal Revenue Service ("IRS"). It charges that, from 1996 through 2003, HVB – together with KPMG, certain KPMG partners and employees, John Larson, Robert Pfaff, David Amir Makov, San Francisco-based companies controlled by Larson, Pfaff, and Makov and set up to participate in certain tax shelter transactions (the "Larson/Pfaff/Makov entities"),

Raymond J. Ruble, also known as "R.J. Ruble," and others - participated in a scheme to defraud the IRS by devising, marketing, and implementing fraudulent tax shelters. HVB's participation in the scheme centered on its role in purportedly providing financing for fraudulent tax shelter transactions. The Information filed today focuses on 4 tax shelters in which HVB participated - Bond Linked Issue Premium Structure ("BLIPS"), Custom Adjustable Rate Debt Structure ("CARDS"), 357(c), and Common Trust Fund - which, it is charged, generated in aggregate over \$1.8 billion in phony losses reported on United States income tax returns, and the evasion of over \$500 million in income taxes.

According to the charges, HVB and its co-conspirators concocted tax shelter transactions - and false and fraudulent factual scenarios to support them - so that wealthy United States citizens would pay fees to HVB, the Larson/Pfaff/Makov entities, KPMG, law firms, and other firms and individuals instead of paying billions of dollars in taxes owed to the Government. As a result, it is charged, HVB, the Larson/Pfaff/Makov entities, KPMG, and their co-conspirators filed and caused to be filed false and fraudulent tax returns that claimed the phony tax losses. The Information against HVB charges that as part of the conspiracy to defraud the United States, HVB and its co-conspirators prepared false and fraudulent documents to deceive the IRS should it learn of the transactions, including engagement letters, transactional documents, representation letters and opinion letters.

As part of the Deferred Prosecution Agreement entered today, HVB has issued a statement of facts admitting its wrongdoing and has agreed to pay \$29.635 million in fines, restitution, and penalties by February 17, 2006, \$6 million of which HVB agreed to pay by way of a forfeiture to the United States. The Agreement provides that prosecution of the criminal charge against HVB will be deferred for a period of eighteen months, until August 2007, if specified conditions are met. At the end of the period of deferral, if HVB has fully complied with all the terms of the Agreement, the Government will move to dismiss the Information. The Agreement also requires permanent restrictions and controls on HVB's banking practices, including, among other things, (i) prohibitions on HVB's participation in any transaction or strategy that has a significant tax component, unless such transaction or strategy is accompanied by an opinion that the transaction "should" be upheld by the courts if litigated, and HVB independently concurs with that opinion; (ii) a requirement that HVB adopt a new "transaction approval" process for loan officers that involves review and approval, by its Tax Director, of any transaction that has a significant tax component; (iii) operational controls that will prevent account officers from controlling banking transactions

after the formal closing of the transactions; (iv) HVB's implementation and maintenance of an effective Compliance & Ethics program in conformity with the United States Sentencing Guidelines; and (v) HVB's full and truthful cooperation in the pending criminal investigation, including voluntarily providing information and documents. The Agreement provides that its provisions regarding the restrictions and controls for the banking practices and the bank's cooperation remain in effect after charges against the firm are dismissed.

In a statement issued in connection with the Deferred Prosecution Agreement, HVB admitted that its fraudulent activities in connection with the four tax shelter transactions included: (i) participating in transactions purporting to be "loans" but which were not bona fide loans; (ii) participating in trading activity on instructions from promoters that was intended to create the appearance of investment activity but that had no real substance; and (iii) participating in creating documentation that contained false representations concerning the purpose and design of the transactions.

Specifically with respect to BLIPS transactions, HVB admitted that: (i) the non-bona fide "loans" were not funded and were structured to provide the false impression that they were seven year "loans" involving a purported "loan premium", neither of which was true, but was necessary to provide the illegal tax benefits sought by the clients; and (ii) the purported "loans" had no business purpose other than reducing taxes of the BLIPS customers. HVB also admitted that it helped prepare and execute documents that made it appear that the BLIPS "loans" were part of a purported "highly leveraged" investment program. In fact, as alleged in the Information and as admitted by HVB, there was no "highly leveraged" investment program because the "loan funds" had to be kept at the bank for collateral purposes and could not be used for the transactions that were supposedly at the heart of the purported "investment program". Moreover, HVB admitted that, the money used to pursue the so-called investment program came not from any "loan" but from cash contributed directly by the clients engaging in the BLIPS transactions. HVB further admitted that the BLIPS transactions were falsely described as involving seven-year loans whereas, in truth, the participants understood that the transactions would unwind in approximately 60 days. HVB also admitted that it contemporaneously reviewed the BLIPS opinion letters prepared by the promoters and knew they were based on incomplete, false and misleading representations, including those regarding HVB's involvement in the critically important "loans".

With respect to CARDS, HVB admitted that those

transactions involved false and fraudulent representations regarding the duration of the purported financing underlying the transaction, which was touted as a transaction involving a "30-year loan" but which, in truth, was designed to close out within a year. HVB also admitted that it knew that the CARDS transactions involved false claims that clients were entering into certain transactions for legitimate business purposes, whereas the clients' motivations were in fact to get a tax loss.

In addition to the foregoing, HVB admitted that it participated in CARDS and other fraudulent tax shelter transactions – known as 357(c) and Common Trust Fund transactions – that involved the participation of ostensibly independent third parties who were not residents of the United States. HVB admitted that these foreign, tax-neutral parties were injected into the transactions not for any legitimate business reason but, instead, to act as nominees and puppets of the promoters of the fraudulent tax shelters. According to the Information, the CARDS opinion letters were written by an attorney at a prominent national law firm that also supplied an attorney to purportedly represent the foreign puppets purportedly involved in the same transactions.

Mr. GARCIA said that the decision to file a charge against HVB was based on several factors set forth in the Department of Justice Principles of Federal Prosecution of Business Organizations ("Principles"), including: (1) the seriousness of HVB's conduct, which resulted in over \$500 million dollars in evaded taxes and other significant losses to the United States Treasury; (2) the duration of HVB's fraudulent tax shelter conduct, which lasted from 1996-2003; (3) the involvement of a senior officer in HVB's New York office, Domenick DeGiorgio (who has previously pleaded guilty in the investigation), and the knowledge of HVB's highest-level management of HVB's participation in the shelters; (4) HVB's failure to cease its illegal activity despite its knowledge of notices issued by the IRS warning the public about the shelters and advising the public that the IRS viewed them as invalid and possibly criminal; and (5) HVB's failure to voluntarily disclose its wrongdoing to the IRS during the course of an IRS Promoter Penalty Audit into HVB's shelter activity, and HVB's failure to provide truthful testimony and information at hearings into the tax shelters conducted by the Senate Permanent Subcommittee on Investigations.

On the other hand, Mr. GARCIA said, the decision to defer prosecution of HVB on the Information was based on a variety of factors and considerations set out in the Principles, including the relative volume of HVB's tax shelter transactions compared with other institutions; HVB's prompt and complete cooperation with the criminal investigation, including by

voluntarily disclosing wrongdoing; HVB's frank acknowledgment of its own illegal conduct in connection with entry of the deferred prosecution agreement; HVB's agreement to institute additional, significant reforms to its compliance program to ensure that this conduct does not recur; and HVB's agreement to disgorge the fees it earned from the shelters, make restitution to the IRS and pay a penalty to the IRS for failure to register shelters.

Mr. GARCIA also stated: "Today, another major institution joined KPMG in admitting that the tax shelters executed by HVB, KPMG and others were fraudulent. KPMG and HVB have admitted that they and their co-conspirators used false and misleading documentation to cheat the Government out of billions of dollars in taxes owed by America's wealthiest citizens. The Government will not tolerate professional firms and financial institutions using 'structured transactions' that are nothing more than fictions designed to enable privileged taxpayers to avoid paying their fair share."

IRS Commissioner MARK EVERSON stated: "It's not just high-priced lawyers and accountants who peddled abusive shelters. As this court proceeding shows, the network of criminality extended to banks and other financial players. I applaud today's actions which demonstrate that blue chip professionals will be held accountable for defrauding the Internal Revenue Service."

Mr. GARCIA said that the investigation is continuing.

Mr. GARCIA praised the extraordinary investigative work of the Internal Revenue Service, Manhattan Criminal Investigation in this case.

Assistant United States Attorneys JUSTIN S. WEDDLE, STANLEY J. OKULA, Jr., MARGARET GARNETT, and Special Assistant United States Attorney and Trial Attorney, United States Department of Justice Tax Division, KEVIN M. DOWNING, are in charge of the prosecution. SHIRAH NEIMAN, Chief Counsel to the United States Attorney is supervising the investigation and prosecution.

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